 CTION 5-2

12 October 1967

MEMORANDUM FOR: John Oliver, Director, Office of Fuels and Energy, Bureau of Economic Affairs, Department of State

SUBJECT: An Assessment of Soviet Threats to US Oil Interests in the Near East

Forwarded in accordance with the agreement reached in the meeting with Mr. Rockwell on 28 September 1967, is the CIA contribution to subject project. The undersigned will be prepared to discuss this contribution in the meeting scheduled for 16 October 1967.

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An Assessment of Soviet Threats to US Oil Interest in the Near East

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An Assessment of Soviet Threats to US Oil Interest in the Near East

1. USSR Capability to Compete in Free World Oil Markets

Forecasts of petroleum supply and demand in the USSR through the period ending in 1975, indicate that Soviet oil will pose no serious threat to the normal flow of oil in Free World markets, or to US oil interests in the Near East. Production of oil in the USSR will be 5.7 million barrels per day in 1967 and may increase to 7 million bpd in 1970 and exceed 9 million bpd in 1975. These rates of output will correspond to slightly less than 20 percent of total world oil production in each of those years.

Rising demand for oil in the USSR and other Communist countries, resistance to Soviet oil in Free World markets, and competition have resulted in a declining rate of increase in Soviet (Communist Bloc) exports of oil to the Free World. In the period 1960 through 1965, Soviet oil exports to the Free World increased at an average annual rate of about 15 percent; in 1966 and 67, the rate of increase is estimated to be about 10 percent. This latter rate is expected to continue through the near term. Exports of Soviet oil to the Free World probably will be slightly more than 1 million bpd in 1970 and about 1.5 million bpd in 1975. Certain recipient countries where total oil demand is small, such as Iceland, Finland, Ghana, and Afghanistan will continue to be heavily dependent on Soviet oil. However, Soviet oil exports will represent less than 10 percent of Western Europe's total

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supply and less than 3 percent of total Free World supply in 1970 and 1975; about the same as at present.

2. Soviet Action Affecting US Oil Interests in the Near East

The broad Soviet objectives in the Near East -- to reduce Western influence and through trade and aid to gain economic advantage at the expense of the West -- constitute threats to US oil interests. However, except as the USSR may have encouraged the nationalization of foreign oil company assets in the Near East, the USSR has taken no direct action, hostile or otherwise, that would significantly affect US oil interests. Recent actions by the host governments of the oil producing countries of the Near East that adversely affected US oil interests, probably would have been taken independently of any encouragement by the USSR. The imposition (and removal) of the selective embargo of oil sales as a result of the Israeli war stemmed from within the Arab states rather than at the bidding or encouragement of the USSR; requests for higher prices for Arab oil arose from selfish, nationalistic recognition of prevailing economic conditions.

Overt Soviet involvement in the Near East petroleum industry has been limited essentially to exploratory activities in Egypt, in the Iranian territory of the Caspian Sea, in Algeria, and in Syria. None of these activities constitutes a direct threat to US oil interests. Expansion of Soviet activities in the production phase of the industry (beyond exploration) in the Near East would necessitate significant changes from the historical economic policies of the USSR and the host governments. The USSR does not provide risk capital in foreign oil

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ventures and is guaranteed payment for its work whether or not oil is found. Conversely, oil companies that search for oil in the Near East under the terms of agreements with the governments concerned, or with national oil companies representing the governments, are repaid for their expenses from the proceeds for the sale of oil if found, or absorb the cost themselves, if oil is not found.

There is no evidence that either the USSR or the governments of oil producing states will depart from these respective positions in the near future. The USSR has sought capital investment from the communist countries of Eastern Europe for expansion of its own oil industry and, thus, probably would not divert capital to foreign oil activities. The producing countries of the Near East, for their part, now have developed resources adequate to meet likely demands for their oil through the next decade and, thus, probably would not risk their capital for the development of oil reserves for which there is no immediate need. Countries that are not now producing would lack capital of their own and funds for oil development activities would have to come from outside sources.

The Soviet-Iranian agreements involving the exchange of Soviet capital and military goods for Iranian gas have mutually beneficial economic advantages for those parties and, rather than representing a threat to US oil interests, may be a force for stability in the area and benefit those interests. The USSR, Iran, and the Consortium recognize one another's importance in the agreements. Iran's credit in world money markets and thus its capability to provide supplementary

foreign exchange for completion of the capital projects envisaged as part of the agreements is dependent on the continued export of Iranian oil through the marketing apparatus of the Consortium. Moreover, the successful fulfillment of the gas supply contract depends on the uninterrupted production of oil since the gas occurs in association with the oil.

3. Actions to Minimize Threats to US Oil Interests

There are actions that might be taken to minimize Soviet threats, real or potential, to US oil interests in the area. Such actions, however, probably would be unacceptable to the oil companies. In those circumstances where concession areas, in which there is US oil interest, are relinquished voluntarily or, as in the case of Iraq's North Rumalia oilfield, denied by government fiat, non-US oil companies from other Free World countries might be encouraged to bid for contracts to exploit released areas as they become available. It is unlikely that the USSR would be willing, or able, to bid against Western oil companies on as generous terms.

US oil interests traditionally have reacted to demands of the host governments for modification of commercial agreements by liberalizing the terms. The elimination of the marketing fees, the expensing of royalties, and the increased payments for pipeline transit are examples. The oil companies, rather than reacting, might anticipate possible demands, particularly where such demands are legitimate or reasonable, and seize the initiative by making unsolicited proposals to the governments. Such initiative might deny the USSR opportunities for creating dissatisfaction in those countries.

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The actions outlined above to minimize direct threats by the USSR to US oil interests would, of course, erode company profits in the short term and whet the appetites of the countries for additional liberalization of the agreements. The actions might, however, forestall adverse action by those governments and permit US oil interests to borrow time in which to reduce the Free World's dependency on Near East oil by locating new sources outside the area or develop alternative sources of energy.

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